

JEI

R E P O R T

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Japanese Plant And Equipment Spending On Plateau

A series of recent Japanese surveys could cause a few nightmares among that nation's business leaders even though similar findings would cause few American managers to lose sleep. Operating profits as well as plant and equipment spending may have stopped rising after typically showing double-digit growth rates since Japan began pulling out of a recession in late 1986. The Bank of Japan's Short-Term Economic Survey of Enterprises, conducted in February and released March 6, showed that the 690 large firms polled planned to increase investment in plant and equipment a scant 1.1 percent on average in fiscal 1991, which begins April 1 (see Table). The results suggest a leveling off of capital spending, which rose 18 percent in FY 1989 and is expected to increase 15 percent in FY 1990.

BOJ's results are consistent with those of two other surveys, both of which also were conducted in February. A Nippon Credit Bank, Ltd. poll of 1,506 large and small companies showed that the firms on average planned to increase their plant and equipment spending only 2 percent in FY 1991. The results of a

survey of 1,500 firms by Nihon Keizai Shimbun, the economic daily, revealed an expected 2.1 percent rise in FY 1991 business investment in contrast with the 15.5 percent jump anticipated this year.

None of the surveys purports to be a representative sample of all Japanese firms. Small businesses are underrepresented, if polled at all. As

Capital Spending Survey of Large Firms, FY 1990-FY 1991

(change from previous fiscal year)

	<u>FY 1990 Estimated</u>		<u>FY 1991 Projected</u>	
	<u>Operating</u>	<u>Capital</u>	<u>Operating</u>	<u>Capital</u>
	<u>Profits</u>	<u>Spending</u>	<u>Profits</u>	<u>Spending</u>
<u>Manufacturing</u>				
Food Products	4.4%	-1.8%	0.8%	-9.6%
Textiles	-3.3	6.7	3.7	2.4
Paper and Pulp	-49.8	-1.6	7.4	-43.5
Chemicals	-8.3	11.6	1.9	0.7
Petroleum Products	42.6	31.1	1.9	0.8
Nonmetallic Mineral Manufactures	-15.3	33.3	3.1	2.7
Steel	-15.2	34.2	-14.0	6.3
Nonferrous Metals	2.8	34.7	1.4	5.4
Fabricated Metal Products	11.1	53.5	4.9	2.8
Nonelectric Machinery	8.9	44.9	2.1	-7.7
Electric Machinery	3.4	15.4	0.4	-2.3
Shipbuilding and Heavy Machinery	16.2	37.4	6.5	3.2
Motor Vehicles	1.1	30.3	-2.2	4.5
Precision Instruments	19.3	23.0	5.6	-6.0
Average Manufacturing	-0.3	21.2	-0.1	-1.1
<u>Nonmanufacturing</u>				
Construction	22.5	17.2	4.9	-7.7
Real Estate	7.2	18.6	0.9	-0.8
Trading Companies	3.3	8.5	4.5	-11.8
Retailing	6.2	8.2	5.2	10.3
Transportation and Communications	-2.4	11.1	0.7	4.7
Electric Power	n.a.	9.8	n.a.	3.5
Gas Supply	n.a.	7.5	n.a.	2.5
Electric Power and Gas Supply	-36.8	n.a.	-1.8	n.a.
Services	6.1	35.5	7.5	-12.1
Leasing	-30.7	21.4	-7.8	3.7
Average Nonmanufacturing	-1.7	13.9	2.9	2.7
Average All Industries	-0.8	16.9	1.0	1.1

Source: Bank of Japan

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reports of intentions, moreover, the investment plans are subject to revision. In the past firms usually have ended up spending more than they initially predicted. Furthermore, companies probably were especially pessimistic in February while war was raging in the Middle East.

Corporate managers, however, still have reason to worry to the extent the surveys reflect their own firm's situation and that of their customers. The Nippon Credit Bank survey showed firms were more pessimistic than in the bank's July survey, when they had said they would spend 4.5 percent more in FY 1991. In addition, the results do not reflect the effects of inflation. An adjustment for recent price increases in plant and equipment would shave at least a percentage point off the reported figures. The somewhat unreliable data available for small- and medium-sized firms suggest that, if anything, they are less optimistic than their larger counterparts. These considerations point to a real possibility of essentially unchanged -- or even somewhat lower -- real capital spending in FY 1991.

As the table shows, profits also are close to a plateau. Smaller expected earnings imply that investment projects are less likely to pay off. For example, if existing products are less profitable than previously, planned new products are likely to generate lower earnings than initially expected. This presents the likelihood of delay or postponement of plant and equipment spending. Recently released consumer spending data for November through January, which showed increased caution on the part of Japanese consumers, may have been a factor in the investment and profit survey results; manufacturers, whose sales and profits reflect more the whims of consumers than do those of nonmanufacturers, were much less optimistic than their counterparts in other industries. Within the manufacturing sector highly cyclical industries like pulp and paper forecast particularly sharp declines in profits and expected investment. To the extent that the apparent weakness in Japanese consumer spending continues, investment plans could be revised downward, with cyclical industries scaling back the most.

If the survey results cause insomnia on one side of the Pacific, could they serve as a tranquilizer on the other? Such use would stem from a misreading of the data and a misdiagnosis of the American economic patient. The surveys suggest that Japan's plant and equipment spending will change little. That is cause for continuing concern among American business leaders worried about facing ever more competitive Japanese rivals, since profit and investment levels in Japan still will be high. During FY 1989 plant and equipment spending came to 18.7 percent of nominal gross national product in Japan, a figure nearly double the corresponding American figure. The survey results, if confirmed by actual experience, would imply little change on Japan's side in the relative size of private capital spending as compared to that of U.S. firms.

At the same time, the concern among some Americans about Japanese capital spending is overdrawn. High levels of plant and equipment investment in Japan may pose a threat to particular U.S. industries or companies that face more competitive Japanese rivals, but this may not necessarily impinge on the U.S. economy as a whole. The effect of more capital spending in Japan generally is to increase the productive capacity of that economy, with higher levels of imports as well as exports. In the current expansion managers typically have used plant and equipment spending for purposes other than that of boosting their own firm's potential output. For example, investment in labor-saving

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equipment has minimized bottlenecks in the economy created by a shortage of workers. In such situations exports are larger or smaller depending on how the higher real incomes generated by the expansion are spent or saved. For this and other reasons the United States could end up a winner from higher Japanese levels of plant and equipment spending. In other words, higher business investment in Japan could serve as a medicine for the U.S. economy, but one that has nasty side effects for some American industries. Current trends suggest that American firms should prepare to live with about the same-sized potion over the next 12 months.

Douglas Ostrom

Financial Reform Advances On Multiple Fronts

Although only a few months old, 1991 already is a milestone year for the financial systems of both the United States and Japan. History might record it as a watershed year as well. Both in Washington and Tokyo efforts are under way to restructure fundamental aspects of their respective postwar national financial systems. While the Bush administration has bundled together proposals that could lead to sweeping changes over the long term, the government of Prime Minister Toshiki Kaifu continues to follow its predecessors' incremental approach to financial liberalization. Nevertheless, the scope of Tokyo's effort is as broad as Washington's and already is influencing events in Japan's financial world.

Both the United States and Japan have been struggling for the past several years with a legacy of the Great Depression: laws that prevent banks and securities companies from entering each other's field of business. The Ministry of Finance gradually has been building a consensus between the banking and the securities industries to bridge the business barriers imposed by Article 65 of the Securities and Exchange Law, the Japanese counterpart to the Glass-Steagall Act of 1933. Two advisory councils -- the banking-affiliated Financial Systems Research Council and the brokerage industry's Securities and Exchange Council -- have submitted initial reform recommendations to MOF (see JEI Report No. 25B, June 29, 1990). After studying these reports the ministry has drawn up a list of proposed changes for discussion by both advisory bodies. MOF hopes that both councils will submit their final reports by the middle of this year, leaving officials time to incorporate the results of the studies in new legislation to be developed for submission to the next regular session of the Diet.

MOF's draft suggestions, released February 28, are less sweeping than major commercial banks and even the ministry originally had hoped. Rather than allow banks and brokers to go head-to-head via wholly owned subsidiaries in any market they wish, MOF's proposal limits competition to only a few markets. Commercial banks would gain permission to establish underwriting and trust bank subsidiaries, while stock brokers could start trust bank operations. Trust banks would be allowed to participate in the securities market, and nonbank financial institutions, such as leasing firms and consumer credit companies, could engage in foreign exchange dealing as well as accept deposits and settle financial obligations between clients and third parties.

As a sop to banks and brokers worried about the competitive threat posed by the other, the activities of the new, ground-breaking subsidiaries would be

STATISTICAL SUPPLEMENT

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1988	1989	January- December 1989	January- December 1990	October 1990	November 1990	December 1990
Japan's Balance of Payments							
Trade Balance	\$95,012	\$76,917	\$76,917	\$63,856*	\$5,986*	\$4,515*	\$8,199*
Exports (f.o.b.)	259,765	269,570	269,570	280,177*	26,002*	25,008*	27,697*
Imports (f.o.b.)	164,753	192,653	192,653	216,321*	20,016*	20,493*	19,498*
Current Account Balance	79,631	57,157	57,157	35,792*	2,733*	1,749*	3,713*
Long-Term Capital (net)	-130,930	-89,246	-89,246	-43,455*	7,092*	-2,850*	-5,379*
Overall Balance	-28,982	-33,286	-33,286	-7,234	-471	5,901	-2,564
International Reserves (end of period)	97,662	84,895	84,895	77,053	76,190	76,672	77,053
Japan's Customs Clearance Trade							
Trade Balance	77,563	64,328	64,328	52,149	3,235	2,247	5,437
Exports (f.o.b.)	264,917	275,175	275,175	286,948	26,725	25,743	28,366
Cars	38,671	38,804	38,804	41,362*	3,750	3,763	3,922*
Steel	15,322	14,789	14,789	12,513*	1,149	1,034	1,339*
Imports (c.i.f.)	187,354	210,847	210,847	234,799	23,491	23,496	22,929
Crude Oil	18,852	21,544	21,544	31,559*	3,628	4,569	5,045*
Manufactured Products	91,838	106,111	106,111	118,028*	11,703	10,940	10,325*
Japan-U.S. Trade							
Trade Balance	47,597	44,943	44,943	38,025*	3,723	3,563	3,486*
Exports (f.o.b.)	89,634	93,189	93,189	90,312*	8,466	8,082	8,221*
Imports (c.i.f.)	42,037	48,246	48,246	52,287*	4,744	4,519	4,735*
Yen-Dollar Exchange Rate (average for period)	Y128.15	Y137.96	Y137.96	Y144.79	Y129.73	Y129.08	Y133.55
U.S. Trade							
Trade Balance	-118,526	-109,399	-109,399	-100,997*	-12,805	-9,996	-6,217*
Exports (f.a.s.)	322,426	363,812	363,812	394,045*	35,296	33,689	33,074*
Imports (Customs)	440,952	473,211	473,211	495,042*	48,101	43,685	39,291*
U.S.-Japan Trade							
Trade Balance	-51,793	-49,059	-49,059	-41,071*	-4,453	-3,788	-3,439*
Exports (f.a.s.)	37,725	44,494	44,494	48,585*	4,250	4,351	4,371*
Imports (Customs)	89,518	93,553	93,553	89,655*	8,703	8,139	7,810*

*Preliminary

STATISTICAL SUPPLEMENT

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1988	1989	January- December 1989	January- December 1990	October 1990	November 1990	December 1990
<u>Discount Rate (end of period)</u>	2.5%	4.25%	4.25%	6.0%	6.0%	6.0%	6.0%
<u>Outstanding Money Supply</u>	11.2%	9.9%	9.9%	11.7%	11.8%	9.9%	8.5%
<u>Industrial Production</u>	9.5%	6.1%	6.1%	4.6%	8.2%	6.8%	6.0%
<u>Manufacturing Operating Rate</u>	5.9%	2.2%	2.2%	2.3%	5.5%	3.7%	3.3%
<u>Number of Bankruptcies</u>	-20.0%	-28.5%	-28.5%	-10.6%	9.7%	23.2%	44.8%
<u>Residential Construction Starts</u>	0.6%	-1.3%	-1.3%	2.7%	0.7%	-3.7%	-1.4%
<u>Job Openings to Applications (ratio)</u>	1.01	1.26	1.26	1.40	1.42	1.41	1.43
<u>Nominal Wages</u>	3.8%	4.7%	4.7%	5.1%	4.7%	4.2%	6.1%
<u>Manufacturing Labor Productivity</u>	11.5%	6.2%	7.1%*	3.7%*	6.5%	n.a.	n.a.
<u>Wholesale Prices</u>	-1.0%	2.5%	2.5%	2.1%	1.5%	2.0%	2.2%
<u>Consumer Prices</u>	0.7%	2.3%	2.3%	3.1%	3.5%	4.2%	3.8%
<u>Yen-Based Export Prices</u>	-2.2%	4.4%	4.4%	2.2%	-4.0%	-4.8%	-3.2%
<u>Yen-Based Import Prices</u>	-4.6%	7.7%	7.7%	8.7%	9.7%	10.5%	11.5%

*Through October of each year only.

For Japan's latest GNP figures, see JEI Report No. 47B, December 14, 1990.

NOTE

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Entire Issue
